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DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: April 15, 2004

Number:

Release Date:

Contact Person:

Identification Number:

Contact Number:

UIL: 501.00-00

Employer Identification Number:

Dear [REDACTED]:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You state that you are an [REDACTED] nonprofit corporation formed [REDACTED]. Your application Form 1023 provides that you were organized to provide education and assistance to residents of low-income housing in the form of down payment assistance. You subsequently withdrew your down payment assistance program and stated in your letter of May 22, 2003 that your activities would instead be focused on your quality affordable housing program. You do acknowledge that you will utilize down payment assistance programs operated by other nonprofit organizations.

You state that 90% of your activities will be engaged in the rehabilitation, development, management or sale of affordable housing. Additionally, you state 10% of your activities will involve providing low-income homeowner education by becoming a HUD-certified housing counseling agency. The activities will be conducted by your employees and volunteer staff. Under your affordable housing program, you state that you will identify blighted properties, redevelop the properties, and operate them or re-sell them. You may conduct operations through partnerships with other nonprofit companies. You expect to lower vacancy and expenses and thus operate the facilities at a profit. You state that you will limit your program to persons at or below 75% of the local county's median income.

We asked how you will make the housing expenses affordable for the low-income residents with whom you plan to deal. You said that down payments will be 0% to 1% of the purchase price, with additional assistance provided from other nonprofit down payment assistance programs, and that the mortgages will be fixed.

[REDACTED]

Your bylaws provide that your board of directors controls the corporation. Your board of directors is currently composed of two individuals, [REDACTED] and [REDACTED], the owners and officers of [REDACTED], an [REDACTED] for-profit corporation doing business as [REDACTED]. Additionally, you state that your officers are employees of [REDACTED].

[REDACTED]. We asked you to adopt a bylaws provision that would require a majority of board members having no financial interest in your affairs, and you refused. You have not specified with whom you may contract for development or management services, although you will solicit multiple bids and make decisions based on the contractor's ability to deliver the best goods and services for the best reasonable price.

You state that the mission of [REDACTED] is to renovate existing real estate for the purpose of creating quality, affordable residential properties. You acknowledge that both you and [REDACTED] share very similar goals. You state that [REDACTED] has been involved in providing affordable housing for over [REDACTED] years and that currently 100% of your activities are conducted by [REDACTED] and its employees. Additionally, you state that [REDACTED] and its employees have missed many housing project opportunities simply because of the lack of nonprofit status, that certain properties can only be purchased and operated by nonprofit organizations, and that the properties that you will purchase will be those that cannot be purchased by a for-profit entity.

Section 501(c)(3) of the Internal Revenue Code provides an exemption from taxation for organizations organized and operated exclusively for charitable and educational purposes including for the prevention of cruelty to animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations states that an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized or operated exclusively for exempt purposes under section 501(c)(3) of the Code unless it serves a public rather than a private interest. In order to meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, shareholders of the organization or persons controlled, directly or indirectly by such private interests.

Section 1.501(c)(3)-1(d)(2) of the Regulations defines the term "charitable" as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration.

Rev. Rul. 67-138, 1967-1 C.B. 129 holds that a nonprofit organization created to provide instruction and guidance to low-income families in need of adequate housing and interested in building their own homes is exempt under section 501(c)(3) of the Code. The organization's training of low-income families on various aspects of house building and homeownership was educational. The activities related to assisting families find adequate housing was charitable as it provided relief to the underprivileged, lessened the burdens of government and was a means of combating community deterioration.

Rev. Proc. 96-32, 1996-1 C.B. 717, set forth a safe harbor under which organizations that provide low-income housing will be considered charitable for relief of the poor and distressed, and described the facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed. It also clarified that housing organizations may rely on other charitable purposes to qualify for recognition of exemption. The safe harbor requires that the housing be affordable to the charitable beneficiaries. In the case of rental housing, this requirement will ordinarily be satisfied by the adoption of a rental policy that complies with government-imposed rental restrictions or otherwise provides for the limitation of the tenant's portion of the rent charged to ensure that the housing is affordable to low-income and very low-income residents. In the case of homeownership programs, this requirement will ordinarily be satisfied by the adoption of a mortgage policy that complies with government-imposed mortgage limitations or otherwise makes the initial and continuing costs of purchasing a home affordable to low and very low-income residents. Facts and circumstances that demonstrate relief of the poor may include, but are not limited to, the following:

- (1) A substantially greater percentage of residents than required by the safe harbor with incomes up to 120 percent of the area's very low-income limit.
- (2) Limited degree of deviation from the safe harbor percentages.
- (3) Limitation of a resident's portion of rent or mortgage payment to ensure that the housing is affordable to low-income and very low-income residents.
- (4) Participation in a government housing program designed to provide affordable housing.
- (5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization's operations.
- (6) The provision of additional social services affordable to the poor residents.
- (7) Relationship with an existing 501(c)(3) organization active in low-income housing for at least five years if the existing organization demonstrates control.

[REDACTED]

(8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.

(9) Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.

(10) Existence of affordability covenants or restrictions running with the property.

In Better Business Bureau of Washington, D.C. v. U. S., 326 U.S. 279 (1945), the court held that an organization was not organized and operated exclusively for charitable purposes. The court reasoned that the presence of a single nonexempt purpose, if substantial in nature, would destroy the exemption regardless of the number or importance of truly exempt purposes.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), a nonprofit organization paid a for-profit corporation for the licenses to conduct "est" programs. The est programs involved training, seminars, and lectures in the areas of intrapersonal awareness and communication. The court held that an organization's denial of exemption was proper because the organization had a substantial commercial purpose that served private rather than public interests. Although the nonprofit claimed that it had no connection, direct or indirect with the for-profit, the court found that the for-profit exerted considerable control over the nonprofit's activities. The nonprofit's only function was to present to the public for a fee, ideas that were owned by the for-profit with materials and trainers supplied by the for-profit. Regardless of whether the payments made by the nonprofit to the for-profit were excessive, the for-profit benefited substantially from the operation of the nonprofit. The nonprofit was the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of the for-profits.

In KJ's Fund Raisers, Inc. v. Commissioner, 74 T.C.M. 669 (1997), the court held that a nonprofit organization, which sold lottery tickets on the premises of a for-profit business had a substantial non-exempt purpose to enhance the profits of the for-profit business. The owners of the for-profit business to purportedly raise funds for distribution to charitable causes formed the nonprofit organization. The nonprofit's lottery tickets were sold during the regular business hours by the owners and employees of the for-profit business. The owners of the for-profit initially controlled the board and later indicated that it would vest control in unrelated parties. The nonprofit opined that the organization "would fold without the original founders of the organization as officers." In finding that the nonprofit had a substantial nonexempt purpose, which was promoting the for-profit, the court reasoned that the identity of the for-profit owners and the officer of the nonprofit, placed the owners of the for-profit in a position to control the nonprofit. Additionally, the court found that the publicity received by the for-profit was a significant benefit.

You have failed to establish that your operations will further a charitable purpose, and that you will not be operated for a substantial nonexempt private purpose.

[REDACTED]

You have failed to establish that your operations will be charitable through relief of the poor and distressed. While you may deal exclusively with persons who are considered low-income, you have not established that you will meet the safe harbor of Rev. Proc. 96-32 for dealing with "low-income" persons. You also have not established that your housing sale and rental programs will be affordable to such persons. You have not established that you will comply with government-imposed rent restrictions or limitations of rent to an affordable level. With regard to sales activities, you have indicated only that you will provide for low downpayment costs, and that some of this subsidy will come from other nonprofit downpayment assistance organizations. You have failed to show how continuing costs will be made affordable. Moreover, you lack many favorable factors set forth in the facts-and-circumstances test, such as serving excess very-low-income persons, limitation of rent or mortgage payments, participation in a government affordable housing program, a community-based board, relationship with an existing 501(c)(3) organization, and affordability covenants running with the property.

Housing organizations may also be charitable through combating community deterioration. However, the mere redevelopment of blighted areas is not necessarily a charitable activity, as for-profit organizations often engage in such activity. You have not clearly established facts and circumstances demonstrating a charitable endeavor here, such as participation in a government grant program and community participation and control of your board. See, e.g., Rev. Rul. 68-17, 1968-1 C.B. 247, and Rev. Rul. 70-585, 1970-2 C.B. 115.

You also have failed to establish that your activities will not serve the private interests of or its owners, directors, and officers. As stated in Better Business Bureau of Washington, D.C., 326 U.S. 279, the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption, regardless of the number or importance of truly exempt purposes. Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization does not operate exclusively for exempt purposes if it operates for the benefit of private interests.

You state that [REDACTED] operates in substantially the same field as you, but as a for-profit entity, it cannot bid on certain projects. You were formed by the owners of [REDACTED] to be able to bid on nonprofit projects. While you exist as a separate legal entity, you are clearly controlled by the officers and directors of the for-profit entity, [REDACTED].

[REDACTED] Your officers and directors are employees and/or owners of [REDACTED]. You have not ruled out [REDACTED] as a contractor to provide all or most of your development and management services. While you state that you plan to have community members on your board, you have rejected a bylaws provision that would require control by disinterested persons. Moreover, est of Hawaii and KJ's Fund Raisers, Inc. held that the nonprofit's activities served the commercial purposes of the for-profit organizations that formed them, even where individuals unrelated to the for-profit organizations formally controlled the nonprofit.

[REDACTED]

You also have indicated that you may conduct your operations through partnerships. You have failed to furnish information sufficient to establish that the operation of such partnerships will not unduly benefit private interests involved.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
TE/GE (T:EO:RA:T:2)  
[REDACTED]  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

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[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Marvin Friedlander  
Acting Manager  
Exempt Organizations  
Technical Group 2

Bcc:

[REDACTED]